Examiner's report

F6 Taxation (PKN)
June 2012

ACCA

General Comments

The examination paper consisted of five compulsory questions. Question one for 30 marks and Question two for 25 marks, focused on income tax affairs of a company and an individual, respectively. Question three, carrying 20-marks, covered capital gains. Question four having 15 marks examined different areas of the syllabus and was mostly narrative. Question five was set on sales tax and was for 10 marks.

A majority of the candidates attempted all five questions, and there was no evidence of time pressure. Where any question was left unanswered, it was probably due not knowing the reply, as evidenced more from question four. Overall performance of the candidates indicated good knowledge of the level required at this stage. Many candidates got good marks. Answer scripts of the candidates who fell short of passing marks indicate that they could have achieved passing marks with a little more effort by:

i. covering the entire syllabus enabling them to attempt all questions;
ii. not giving more than the required details, so saving time for the points requiring more concentration and time;
iii. improving layout of answers specially in computational questions; and
iv. knowing the amendments made in the Finance Acts being examined as given in the syllabus guide;

Specific Comments

Question One

Question one was about the income tax liability of a listed public company. The question was split in two parts. Most candidates answered part (a) quite well. However, part (b) carrying three marks was not answered correctly in the majority of the scripts as they did not allow the tax credit admissible to the company.
Common mistakes found in different scripts are commented below:

Part (a)

Computation of taxable income

i. Some candidates started their answer with the gross profit figure and then deducted admissible deductions and expenditure to arrive at taxable income. While adopting this layout, they appeared to be confused about whether to deduct or add back amounts that were not admissible in the income tax ordinance. With this layout, only admissible amounts of operating expenses, tax depreciation and initial allowance were to be deducted from the gross profit. A number of candidates adopting this approach added back inadmissible items given in the question under the head 'operating expenses' to the gross profit. This treatment was obviously wrong as no such expense was deducted by the company to arrive at the figure of gross profit.

ii. Under the Income Tax Ordinance, the gain and loss on revaluation of assets are not taxable events. Hence, the exchange gain of Rs. 25,000 on revaluation of US $ and Rs. 15,000 resulting from the revaluation of the sawing machine were not taxable. Many candidates incorrectly treated them as taxable.

iii. Some candidates treated profit from saving accounts under the Final Tax Regime [FTR] whereas it was to be taxed under normal law in the case of companies under the head 'Income from Other Sources.' [Taxpayers in whose hands, profit on debt is to be treated as business income, are not examinable in this paper.]

Future candidates must be able to distinguish incomes which are taxable under normal law from the incomes taxable under FTR, as the tax liabilities and other tax obligations are different in each category.

iv. A few candidates incorrectly treated income from leased out manufacturing unit under the head "Income from Property". Income from a building given on lease together with machinery is assessable under the head "Income from Other Sources". Incorrect classification, consequently, led to wrong deductions.

Part (b)

Tax credit at 15% of tax payable is admissible in the tax year in which a company is enlisted on any registered stock exchange in Pakistan. [s. 65C] Most candidates seemed unaware of this provision of law as they did not give this tax credit of Rs. 73,815 to Shisham Ltd while computing its tax liability.

Question Two

This question carried 25 marks and was set around a salaried individual who also derived income falling under the head "Income from Business".

The question was generally well attempted. Mistakes found included:

i. Electricity allowance at 10% of basic salary

Some candidates exempted this amount without realising that such exemption had been withdrawn way back in the Finance Act, 2006.

ii. Commission received from the employer

The definition of salary given in the tax law includes commission received from an employer in connection with his employment. Many candidates treated it wrongly as income assessable under the Final Tax Regime [FTR] instead of 'salary' income.

iii. A number of candidates taxed Rs. 200,000 received as gratuity whereas this amount was exempt, being received from a gratuity fund approved by the Commissioner of Inland Revenue.

iv. Re-imbursement of medical charges of Rs. 80,000

Re-imbursement of medical charges is exempt [under Cl. (139) of Pt. I of the Second Schedule] subject to certain conditions. One condition is that the medical bills should bear the national tax number of the hospital providing the treatment. Since this condition was not fulfilled, the amount was fully taxable in the hands of Mr Musa.

v. Many candidates made a mistake in not giving full tax credit of the amounts deducted/collected at source. Few candidates stated wrongly that tax withheld at the time of withdrawal of cash from bank was not adjustable.

vi. While computing “Income from Business”, many candidates disallowed rent paid for the wrong reason that no tax was deducted by Mr Musa while making its payment. Candidates were expected to recognise that an individual is not included in the category of persons required to deduct tax on the payment of rent.

Future candidates are reminded to take into consideration all the relevant conditions while deciding taxability or exemption of any given income. Further, they are expected to keep themselves abreast of changes brought about in the Finance Acts from time to time as examinable according to the instructions given in the study guide.

Question Three
This question was mainly set for the calculation of capital gains and carried 20 marks. The question was answered reasonably well by the vast majority of candidates.

However, a few mistakes were found which included:

Part (a)

i. Some candidates did not distinguish between capital gain on ‘securities’ assessable as separate block and capital gain on other assets leading to wrong computation of taxable capital gains and tax payable thereon.

ii. Taxable gain on disposal of capital assets , other than securities, is required to be reduced to 75% where such asset is disposed of after more than one year. A number of candidates did not keep this aspect in view while computing the taxable gain leading to the wrong computation of taxable gains.

iii. A few candidates taxed the gain on sale of horse. Being a movable asset in the use of dependent son of the taxpayer, the gain on the sale of horse was to be treated as exempt from tax.

iv. Many candidates computed capital gain at Rs. 800,000 on sale of the licence to import LPG gas. The correct answer was Rs. 1,000,000. The renewable fee of Rs. 200,000 was wrongly reduced by these candidates from the taxable gain when it had neither altered nor improved the capital asset.

Part (b)

Part (b) carried two marks. The majority of candidates answered it correct that Mr Abdullah was not liable to pay advance tax as his latest assessed taxable income other than salary and final tax regime (FTR) was below Rs. 500,000. Further provisions relating to the payment of advance tax on capital gains on securities were not applicable to an individual.

Question Four
This question carried 15 marks and covered different important areas of the income tax law. Answers of the majority of the candidates were found incomplete or incorrect as discussed below:

Part (a), carrying four marks, dealt with tax implications of non-deduction of tax by a private limited company, DIPL, on the amount of rent paid by it. Tax implications in the given situation were as below:

(i) DIPL was liable to pay tax itself which it failed to deduct from the rent paid.

(ii) DIPL was liable to pay a default surcharge at KIBOR plus 3% per quarter on the amount of tax required to be deducted and paid. The period of default starts from the date it was required to be paid to the Commissioner to the date it was actually paid by DIPL or the payee of the rent.

(iii) The amount of rent paid without tax deduction became an inadmissible expense.

(iv) DIPL became liable to pay a penalty of Rs. 25,000 or 10% of the amount of tax required to be deducted, whichever is higher.

Future candidates are reminded that this area of syllabus is very important and future papers will continue to examine this area in one way or another.

Part (b), carrying three marks, was about penalties. A vast majority of candidates could not answer this part correctly. If a person fails to file a return of income in time, such person shall pay a penalty equal to 0.1% of the tax payable for each day of default subject to a minimum penalty of Rs. 5,000 and a maximum penalty of 25% of the tax payable in respect of the relevant tax year. Based on this provision [Sr. 1 of the table to s. 182(1)], Rose Petals (Pvt) Ltd was liable to pay a penalty of Rs. 35,000 for late filing of the return by 20 days.

Part (c) carried three marks.

Circulars, especially the ones which are beneficial to the taxpayer, issued by the Federal Board of Revenue ('FBR') are an important source of law in dealing with tax obligations. While a circular issued by the FBR is binding on the income tax authorities [excluding Commissioner (Appeals)], they are not binding on the taxpayer. Many candidates were not aware of this correct position of law and replied that they were binding on the taxpayer also.

Part (d) carried five marks and dealt with the advance tax liability of a company in the absence of last assessed taxable income or declared turnover. There was no taxable income during the tax year 2012. In the given situation, advance tax was to be estimated and paid on the basis of the quarterly turnover of the company. On the basis of turnover of Rs. 50,000,000, the company was required to pay minimum tax at 1% of the turnover in four equal installments i.e. an installment of Rs. 125,000 each on 25 September 2011, 25 December 2011, 25 March 2012 and 15 June 2012.
Answers of the majority of candidates were found only partially correct, though a few got full marks. Future candidates are expected to be more prepared to get full marks.

Question Five

Part (a), carrying six marks, tested the candidates' knowledge of "value of supply", which is one of the important parameters to determine the sales tax liability of a registered person, the others being rate of tax, input tax claimed, etc. It is pleasing to note that this part was answered correctly by the vast majority of candidates. Very few, however, answered wrongly about the value of goods supplied on an instalment basis. In the given situation, mark-up was to be ignored and market value of the supply was to be taken at Rs. 850,000 for the purpose of computation of output tax.

Part (b) carried four marks and was about the particulars to be furnished in a sales tax invoice which can be issued only by a registered person. Prescribed sales tax invoice is an important evidentiary document for calculation of tax liability and claiming refunds. It should contain the prescribed particulars. Barring a few, candidates showed a good knowledge of the particulars prescribed to be given in this important document.